

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
WALLACH SONS OF EASTCHESTER, INC. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 1982 :  
through May 31, 1987. :

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DETERMINATION  
DTA NOS. 807942  
AND 807943

In the Matter of the Petition :  
of :  
SIDNEY WALLACH, OFFICER OF :  
WALLACH SONS OF EASTCHESTER, INC. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 1982 :  
through May 31, 1987. :

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Petitioner Wallach Sons of Eastchester, Inc., 695 White Plains Post Road, Scarsdale, New York 10583, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1982 through May 31, 1987.

Petitioner Sidney Wallach, officer of Wallach Sons of Eastchester, Inc., 360 Hungry Harbor Road, Valley Stream, New York 11581, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1982 through May 31, 1987.

A consolidated hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on July 25, 1991 at 1:30 P.M., with allbriefs and documents to be submitted by November 4, 1991. On September 10, 1991, petitioners submitted additional documents pursuant to permission granted

at hearing. On October 21, 1991, the Division of Taxation submitted a letter brief. Petitioner appeared by Nemiroff, Cosmas, Titus & Colchamiro, CPA's (Peter Cosmas, CPA). The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

### ISSUES

I. Whether the Division of Taxation properly subjected to tax certain of the corporate petitioner's claimed nontaxable sales.

II. Whether petitioners have established any basis warranting reduction or abatement of penalty.

### FINDINGS OF FACT

Petitioner Wallach Sons of Eastchester, Inc. ("Wallach Sons") operates a retail jewelry store located in Scarsdale, New York. The business operates out of a street-level location in a shopping strip (not a mall), and has been engaged in business continuously since 1916. Petitioner Sidney Wallach is the president of Wallach Sons of Eastchester, Inc.

On or about July 30, 1985, the Division of Taxation commenced an audit of the business of Wallach Sons of Eastchester, Inc. On August 19, 1985, the Division mailed an audit appointment letter advising Wallach Sons that an initial audit appointment was scheduled for September 23, 1985 and that all books and records should be available for review. Audit activity, including review of records and meetings between petitioners' representative and the auditor, ensued. Ultimately, on April 27, 1988, Wallach Sons, by its duly authorized representative, executed an audit method election form pertaining to the audit period December 1, 1982 through May 31, 1987. Pursuant to this election, it was agreed that in lieu of a detailed audit of all records for the entire audit period, a detailed audit of a representative portion of the audit period would be made by the Division of Taxation. The parties agreed that the audit would pertain to Wallach Sons' sales and recurring expense purchases and, more specifically, that Wallach Sons' claimed nontaxable sales for the test period May 1, 1984 through May 31, 1985 (some 13 months) would be examined in detail.

For the noted test period, Wallach Sons reported nontaxable sales in the amount of \$685,403.75. The majority of such sales were claimed to be nontaxable on the basis of having involved shipments of merchandise to purchaser/recipients in locations outside of New York State. The auditor requested documentation substantiating the nontaxability of such sales, including shipping documents such as postal receipts, United Parcel Service shipment books and/or the like. The record is not entirely clear as to what specific substantiation was furnished in response, except that for at least six months of the test period petitioners were unable to furnish any shipping documents or delivery receipts. After review, the auditor disallowed as unsubstantiated \$446,304.75 of claimed nontaxable sales, resulting in a disallowance rate of 65.12%. The auditor applied this rate to claimed nontaxable sales of \$2,000,032.00 for the entire audit period, resulting in total disallowed claimed nontaxable sales of \$1,302,421.00. In turn, tax was computed thereon in the amount of \$76,629.83.

The results of this test of nontaxable sales were presented to petitioners' representative, in response to which petitioners' representative requested that the Division select another time period and conduct an additional test. According to the audit report offered in evidence, petitioners' representative indicated that "[Wallach Sons] was keeping better records" after the time of the first test, thereby alleging that a second test would present a more accurate portrayal of nontaxable sales (i.e., allow for the presentation of better substantiation thereof).

The Division of Taxation agreed to conduct a second test and the parties agreed to the period June 1, 1986 through May 31, 1987 for such test. For this period, Wallach Sons claimed nontaxable sales of \$243,642.25. After review of documentation presented, the auditor disallowed as unsubstantiated some \$22,001.25 of such claimed nontaxable sales, resulting in a disallowance rate of 9.03%. As with the first test, a lack of shipping documents caused the disallowance of claimed nontaxable sales.<sup>1</sup>

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<sup>1</sup>The auditor who conducted the first test was no longer employed by the Division when the second test was agreed to, and thus another auditor was assigned the case and conducted the second test.

After completing the second test, the auditor combined the results of the two tests to arrive at a "weighted" disallowance percentage. Such disallowance percentage was computed by comparing total disallowed nontaxable sales for both test periods (\$468,306.00) to total claimed nontaxable sales for both test periods (\$929,046.00), resulting in a combined disallowance rate of 50.41%. In turn, the auditor applied such weighted disallowance percentage to claimed nontaxable sales for the entire audit period, resulting in disallowed nontaxable sales of \$1,008,215.00 and tax due thereon in the amount of \$57,972.38.

In addition to the foregoing, the audit encompassed a review of petitioners' recurring expense purchases. Such audit review resulted in the calculation of a use tax liability on such expense purchases in the amount of \$1,740.59 for the audit period.

On November 25, 1988, the Division of Taxation issued to Wallach Sons two notices of determination and demands for payment of sales and use taxes due, spanning together the period December 1, 1982 through May 31, 1987 and assessing tax due in the aggregate amount of \$59,712.97, plus penalty and interest. On the same date, identical notices of determination were issued to petitioner Sidney Wallach, as an officer of Wallach Sons responsible to collect and remit taxes on behalf of the corporate petitioner. Six validated consents had been executed on behalf of Wallach Sons, pursuant to which sales and use taxes for the period December 1, 1982 through August 31, 1985 could be assessed at any time on or before December 20, 1988.

At the commencement of proceedings herein, petitioners admitted liability for the use tax portion of the assessment (\$1,740.59). In addition, petitioner Sidney Wallach agreed and admitted that he was a person responsible to collect and remit taxes on behalf of Wallach Sons pursuant to Tax Law §§ 1131(1) and 1133(a). Hence, the only items at issue herein involve the disallowance of claimed nontaxable sales, and the related issue of whether penalty was properly assessed under the facts in this matter.

Petitioners presented the testimony of their representative herein, who was also petitioners' representative during the audit, as well as the testimony of petitioner Sidney

Wallach. In sum of the testimony, Wallach Sons' usual method of delivery out of state involved U.S. Postal Service shipments. Some 90 to 95% of such out-of-state shipments involved insured, registered mail, return receipt requested. The balance of Wallach Sons' out-of-state shipping was by United Parcel Service or by overnight mail. These shipping methods had been used for years prior to, during and after the audit period herein. Specifically, shipments were logged by Wallach Sons in U.S. Postal Service books, with the return receipts placed in such books when received back by Wallach Sons. Return receipt shipping was used because of the need to verify that the items shipped (jewelry) were, in fact, received.

The audit report's narrative section indicates that after performance of the first test by the Division, and review thereof by petitioners' representative, "[i]t was agreed that a second test of nontaxable sales would be done and a weighted average of both tests would be used to arrive at a disallowed non-taxable percentage." According to the report and to the auditor's testimony, petitioners' representative's reason for requesting a second test was that Wallach Sons' "recordkeeping was greatly improved after the original test period." By contrast, petitioners' representative testified to his belief that the results of the second test only (the 9.03% disallowance rate) would be applied to claimed nontaxable sales for the entire audit period. Petitioners' representative indicated that he raised with the auditor and the auditor's team leader (audit supervisor) the possibility of sending verification letters to Wallach Sons' customers in support of claimed nontaxable sales. He indicated that this procedure was rejected by the Division's auditor and team leader because a second test was to be performed. Petitioners' representative alleged that he did not go forward with the verifications because he believed the results of the second test would be applied to the entire audit period, as described.

Petitioners allege the main problem in substantiating claimed nontaxable (out-of-state) sales for the initial test period resulted from petitioners' inability to locate records, specifically U.S. Postal Service shipping books, for at least a portion of the first test period. Petitioners believe that the records were either misplaced or lost during a storewide renovation which occurred between April 1985 and June 1985, or were destroyed subsequently in a fire occurring

on January 21, 1986 in the back area of the store. Petitioners described the renovation as being a "wall-to-wall" renovation, including the construction of a second story for office space. Wallach Sons' records were kept in the basement of the store. During the renovation, the entire store contents were moved into the basement (the basement was not renovated as part of the overall store renovation). The fire occurred in the back "work area" of the store where inventory cards, inventory and, allegedly, records were kept. Petitioners' post-hearing documentary submission included photographs of the fire area, as well as an insurance report and related litigation documents. According to the report, the fire caused "heavy fire damage to workshop bench area and adjacent door and walls. Heavy smoke damage to jewelry and both adjacent exposure stores...." Photographs showing the fire damage do not, however, as claimed clearly or otherwise show any "burnt records".

Petitioners' representative attempted to obtain duplicate shipping or delivery records from the Post Office. However, he was advised that such records were not kept for more than two years and were not available.

Petitioners submitted in evidence a copy of the confirmation letter their representative prepared (but did not send) together with an invoice for the particular customer named on the letter. The invoice indicates a customer address of Bronx, New York, but a shipping/delivery address of Montpelier, Vermont. The verification letter, addressed to the customer's Bronx, New York location, requests certification that the invoice items were shipped directly to the customer's Montpelier, Vermont address.

Petitioners' representative pointed out that different auditors conducted the two tests, and that there was also a change of team leaders (audit supervisors) during the course of the audit. Petitioners' representative testified that the new supervisor allegedly was willing to apply the disallowance percentage from the second test to the total amount of claimed nontaxable sales for the entire audit period. The auditor who conducted the second test testified to no recollection of such an agreement or statement, but rather that the Division agreed to do a second test because of petitioners' representative's allegation that Wallach Sons' recordkeeping

was greatly improved after the time of the first test.

The Division of Taxation points out that for the first nine quarterly periods covered by the subject audit, approximately 52% of Wallach Sons' gross sales were claimed as nontaxable sales. In turn, for the second nine quarterly periods covered by the audit, approximately 17% of Wallach Sons' gross sales were claimed as nontaxable sales. When questioned about this decrease in claimed nontaxable sales, neither Sidney Wallach nor petitioners' representative could offer an explanation, except the statement that shipping to Florida and the south increased during the summer months due to vacationing families having their purchases shipped to their out-of-state homes.

Sales and use tax returns filed by Wallach Sons (as transcribed and included in the audit report) reveal the following as to the percentage of nontaxable sales claimed for each of the quarterly periods included in the audit:

<u>Period Ended</u>	<u>Percentage of Gross Sales Claimed To Be Nontaxable Sales</u>
2/28/83	33
5/31/83	46
8/31/83	49
11/30/83	61
2/28/84	56
5/31/84	64

8/31/84	55
11/30/84	47
2/28/85	47
5/31/85	22
8/31/85	21
11/30/85	19
2/28/86	21
5/31/86	13
8/31/86	16
11/30/86	12
2/28/87	16
5/31/87	15

CONCLUSIONS OF LAW

A. In this case, the main issue presented is whether petitioners have substantiated that all but 9.03% of their claimed nontaxable sales should be accepted and allowed as nontaxable. Stated more succinctly, petitioners seek to have the results of the second test of their records, from which the 9.03% disallowance rate resulted, applied to all claimed nontaxable sales for the entire audit period. In contrast, the Division seeks to apply the 50.41% weighted disallowance percentage derived by combining the results of the two tests as described. Petitioners accept and do not contest the Division's method of auditing by test period. Petitioners also admit they do not possess shipping or delivery documents in substantiation of a greater percentage of claimed nontaxable sales for the first test period. Simply stated, petitioners argue that if the records for the first test period could have been located, the same would have supported a lower disallowance rate. In turn, petitioners maintain the 9.03% disallowance rate provides a far more accurate result than does the 50.41% weighted disallowance rate.

B. Tax Law § 1135(a) requires a taxpayer to maintain records of all of its sales, and Tax Law § 1132(c) provides a presumption that all such sales are taxable until the contrary is established. Said latter section also places the burden of establishing and substantiating nontaxability upon the person required to collect the tax or the customer. Petitioners argue that if records had been available for the first test period, the same would have supported the 9.03% disallowance rate as opposed to the 65.12% rate and would have refuted the 50.41% disallowance determined by melding the results of the two test periods. However, the evidence



supports a conclusion that petitioners simply maintained better (i.e., more accurate) records of nontaxable sales, as claimed by the Division, for the later periods in the audit. On this score, the significant change (decrease) in the percentage of claimed nontaxable sales commencing almost exactly halfway through the audit period would support the position that petitioners kept better records and more accurately reported their nontaxable sales. Stated differently, this change carries with it an implication that, for earlier periods, a smaller number of sales would have been claimed as nontaxable. This conclusion is supported by the fact that petitioners could offer no explanation for the dramatic decrease in claimed nontaxable sales for the second half of the audit period. In this regard, the statement that more nontaxable purchases are made in the summer months when visitors from the south make purchases and have the items shipped to their out-of-state homes is simply not borne out by the record. The information from Wallach Sons' sales tax returns reveals no apparent seasonal fluctuation in nontaxable sales for the summer months as opposed to the winter months (see, Finding of Fact "17"). Rather, the percentage of claimed nontaxable sales simply drops dramatically commencing with the quarterly period ended May 31, 1985, and continues at the much lower percentages through the balance of the audit period. It is perhaps most telling that the first quarterly period reflecting this decrease in claimed nontaxable sales coincides with the date of notification that an audit would be conducted (compare, Findings of Fact "2" and "17").

C. Petitioners claim they would have sent verifications to their out-of-state customers as to delivery of merchandise in an attempt to substantiate more of their claimed nontaxable sales, but did not do so because of a belief or understanding that the Division would apply only the results of the second test to the entire audit period. However, there is evidence from the Division refuting this claim, stating specifically that the Division intended to compute and apply a weighted average of both tests to determine a disallowance percentage, and that a second test was undertaken only because petitioners' representative claimed Wallach Sons' recordkeeping had improved after the time period of the first test. It is noteworthy that, even assuming petitioners were under the impression that the results of the second test would be applied

throughout the audit period, any misapprehension on this score should have ended in or about November 1988 with the issuance of the subject notices. The results of the audit were discussed prior thereto with petitioners and petitioners' representative. Between such time and the time of the subject proceedings, petitioners could have undertaken submission of verification letters to customers in an effort to provide additional substantiation of claimed nontaxable sales, at least specifically for the first test period. While petitioners were not prevented from doing so, petitioners apparently chose not to undertake this step. Stated simply, Wallach Sons did not have substantiation for some 9% of its claimed nontaxable sales for the second test period and would concede (apparently) to an absence of such substantiation for the entire audit period. Petitioners, in fact, simply seek to have the lesser test period result utilized for the entire audit period, but offer no real compelling reason for applying such percentage in lieu of the weighted percentage derived from both test periods. The balance of evidence, including specifically the percentage change in claimed nontaxable sales, supports a conclusion that the Division's use of both test periods as described to arrive at a weighted disallowance percentage was reasonable. Hence, the results of the audit as applied are sustained.

D. With respect to the imposition of penalty, petitioners have not established in fact how their records in substantiation of claimed nontaxable sales were lost. More significantly, Wallach Sons' increase in reported taxable sales for the second half of the audit period, without explanation or even a claim of any change in business,<sup>2</sup> supports a conclusion that, in fact, better records were kept after the first test period and casts doubt as to the accuracy of claimed nontaxable sales for the first half of the audit period. Such being the case, and absent any significant countervailing evidence, penalties assessed herein are sustained.

E. The petitions of Wallach Sons of Eastchester, Inc. and Sidney Wallach, as officer, are hereby denied and the notices of determination and demands for payment of sales and use taxes due, dated November 25, 1988, are sustained.

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<sup>2</sup>While the store renovation might conceivably have impacted upon the percentage of claimed nontaxable sales, there is no evidence or claim to this effect raised in the record.

DATED: Troy, New York  
May 4, 1992

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE